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ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

Given the dire geopolitical and economic background, investors might have expected a worse outcome for the latest quarter. In fact, if an investor had a well diversified international portfolio of equities and substantial unhedged US exposure, the outcome might well have been positive in sterling terms. The outcome for bonds was less good as investors came to terms with their obvious overvaluation. Gold did not do what it was supposed to do in times of uncertainty and it experienced a poor quarter. Oil also came back in price but, of course, the story was about gas and the Russian use of it as a political weapon.

The tables below detail relevant movements in markets :

International Equities 31.05.22 - 31.08.22

Total Return Performances (%)				
Country	**Local Currency**	**£**	**US$**	**€**
Australia	-2.5	+0.9	-6.8	-0.7
Finland	-1.5	+0.2	-7.5	-1.5
France	-4.9	-3.3	-10.7	-4.9
Germany	-11.8	-10.3	-17.2	-11.8
Hong Kong, China	-5.9	+1.8	-6.0	+0.2
Italy	-11.2	-9.8	-16.7	-11.2
Japan	+2.6	+3.2	-4.8	+1.5
Netherlands	-6.1	-4.5	-11.8	-6.1
Spain	-10.1	-8.6	-15.6	-10.1
Switzerland	-6.1	-0.1	-7.8	-1.7
UK	-3.2	-3.2	-10.6	-4.8
USA	-3.7	+4.3	-3.7	+2.6
All World Europe ex UK	-6.8	-4.5	-11.8	-6.1
All World Asia Pacific ex Japan	-2.8	+2.3	-5.6	+0.6
All World Asia Pacific	-1.0	+2.6	-5.3	+0.9
All World Latin America	-4.0	-3.2	-10.6	-4.8
All World All Emerging Markets	-2.2	+3.1	-4.8	+1.5
All World	-3.6	+2.3	-5.6	+0.6

Source : FTSE All World Indices

FTSE UK Government Securities Index All Stocks (total return) : -6.9%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	31.05.22	31.08.22
Sterling	2.10	2.80
US Dollar	2.85	3.20
Yen	0.24	0.22
Germany (Euro)	1.12	1.54

Sterling's performance during the quarter ending 31.08.22 (%)

Currency	Quarter Ending 31.08.22
US Dollar	-7.9
Canadian Dollar	-4.3
Yen	-0.4
Euro	-1.6
Swiss Franc	-6.1
Australian Dollar	-3.3

Other currency movements during the quarter ending 31.08.22 (%)

Currency	Quarter Ending 31.08.22
US Dollar / Canadian Dollar	+3.7
US Dollar / Yen	+7.9
US Dollar / Euro	+6.7
Swiss Franc / Euro	+5.0
Euro / Yen	+1.1

Significant Commodities (US dollar terms) 31.05.22 - 31.08.22 (%)

Currency	Quarter Ending 31.08.22
Oil	-17.5
Gold	-6.7

MARKETS

International bond and equity markets have ended the quarter on a weak note. Any expected negative correlation of the two asset classes has broken down, at least for the present.

Starting with international equity markets, the total return on the FTSE All World Index in local currency terms was -3.6%, in sterling terms +2.3%, in US dollar terms -5.6% and, in euro terms, +0.6%. Looking at local currency returns firstly, the only positive return in our table was seen in Japan where the FTSE Japan Index returned +2.6%. The weakest area was Europe where the FTSE All World Europe ex UK Index returned -6.8% and, within that, there were particularly weak performances from the FTSE Germany Index, -11.8%, and the FTSE Italy Index, -11.2%. Germany and Italy were particularly dependent on Russian energy and Italy has been destabilised by the political situation, with elections coming up shortly. As the positive return from the FTSE All World Index in sterling terms suggests, currency factors were at play and sterling's weakness enhanced returns from overseas markets. In sterling terms, there were positive performances from the FTSE USA Index (+4.3%), the FTSE Japan Index (+3.2%), the FTSE All World Emerging Markets Index (+3.1%), the FTSE All World Asia Pacific Index (+2.6%), the FTSE All World Asia Pacific ex Japan Index (+2.3%) and the FTSE Australia Index (+0.9%). The weakest area remained the FTSE All World Europe ex UK Index (-4.5%).

In response to rising inflation and tightening monetary policy, bond prices fell. Taking ten year government bonds as a benchmark, the gross redemption yield on the UK gilt rose by 70 basis points to 2.80%, on the US Treasury bond by 35 basis points to 3.20% and, on the German Bund, by 42 basis points to 1.54%. Only in the Japanese Government Bond market did yields fall, by 2 basis points in the case of the ten year bond, as Japan follows a different policy, namely yield control.

The most noticeable feature of the foreign exchange markets was the weakness of the euro, yen and, in particular, sterling. Against the US dollar, sterling fell by 7.9%, against the Swiss Franc by 6.1%, against the Canadian dollar by 4.3%, against the Australian dollar by 3.3%, against the euro by 1.6% and against the yen by 0.4%.

In the commodity markets, there was some relief on oil where the price, as measured by Brent crude, fell by 17.5%. Gold had another disappointing quarter as it fell by 6.7%.

ECONOMICS

Despite the serious geopolitical situation and the poor economic outlook, certainly on the inflation and interest rate front, international equity markets have remained relatively resilient, albeit lower in local currency terms. Whilst this may seem counterintuitive, we have outlined in previous reviews, and will do so here again later, why this is not necessarily surprising. It is a different case for bonds.

In our review, we will necessarily concentrate on the economic aspects of the current situation, even though, in human terms, the geopolitical background is more important, given the shocking tragedy in Ukraine. Given that Russia was unable to achieve its objectives last February when it launched its invasion, Putin now looks to be locked into his current strategy of trying to grind down Ukraine's resistance, whilst Ukraine looks to push back Russia from its territory. At present, it seems a war of attrition. It does not, therefore, look as if there will be any immediate solution to what is looking like a stalemate at present. Putin cannot afford to lose face, so this facet of his character will define Russian policy. That being the case, there is little chance of the malign economic consequences arising from Russia's invasion of the Ukraine lessening. Whilst we will necessarily talk about the economic outlook in this review, it doesn't lessen the appalling human tragedy which the Russian invasion of Ukraine has triggered.

It is difficult to discern much good economic news. Probably, one bright spot is the low unemployment rate in countries like the USA (3.5%), Japan (2.6%), the UK (3.8%), Germany (2.8%) and Australia (3.4%) amongst the large or medium sized economies. Of course, the "Great Resignation", as it is called, has made it difficult for many employers to find staff and this is pushing up wages in a number of areas, hospitality and retail being good examples. These are not unemployment levels consistent with a normal recession and, whatever the reason, are the brightest spot amongst the economic gloom.

Whilst the Russian invasion of Ukraine has had immense economic consequences, many believe that the problems started last year when central banks failed to act to tighten monetary policy in the face of mounting evidence of inflation gathering pace. Central banks considered that the rise in inflation, then apparent in many economies, was "transitory", a word that has quickly disappeared from central banks' language. Those banks which used that adjective to describe the then spike in inflation argued that it was Covid-19 related supply difficulties which were causing the problem and that, once normality returned to the supply chains, prices would subside to around pre Covid-19 levels. With ultra low or negative absolute interest rates, real rates were significantly negative and, against such a background and evidence of day to day price increases, many felt that the central banks' rather dismissive attitude to those who felt that inflation was on the rise and not "transitory", was wrong. And so it proved as, from towards the end of 2021, the word was dropped from central banks' language as the realisation grew that it was a more fundamental problem than the effects of a disrupted supply chain. Economists are notorious for their disagreements about almost everything, but it is possible to sketch out in the most simple and basic terms what the problem was likely to be. As a result of the pandemic, monetary policy was ultra loose both in terms of interest rates and quantitative easing (QE) where central banks created money electronically to buy assets from the private sector, swelling bank reserves. At the same time, governments gave substantial fiscal support to businesses and individuals. If supply had been able to react to very loose monetary and fiscal policy, the problem might not have been so bad, but hosing economies with money in these circumstances was almost certain to start inflationary problems. At an individual level, many people had built up involuntary savings during the pandemic as a result of being unable to spend money, say on holidays or going out for meals, but, as soon as they could, many did and, with limited supplies, prices rose. The contribution of negative real interest rates, which could also be expected to raise asset prices, high government spending, QE and disrupted supply chains create a perfect recipe for rising prices. Of course, at the time, no central bank knew that Russia was going to invade Ukraine, creating more economic havoc in energy and food markets and having a knock on effect on asset prices, at least initially, although markets have recouped some of their losses. But the damage has been done. Probably if central banks had started to tighten monetary policy last year, the inflation position would not be as bad as it is now. To give an idea of current inflation levels, the USA is at 8.5%, the UK at 10.1% and the eurozone at 8.9%. All these levels are, of course well above central banks' target levels and they are expected to get worse as the energy crisis worsens. What central banks fear is that inflationary expectations become embedded in pay negotiations and, hence, exacerbate the inflation position. The UK is one example of this where industrial action is taking place in several areas as unions seek pay increases for their members in line with inflation. In normal times as year on year comparisons are made, the original sharp spike in prices drops out of the comparisons at some stage and the year on year rate falls back. However, with the energy crisis causing prices to rise further, the pain is not over yet and in the UK, for example, there are some scary high double digit forecasts as energy prices rise sharply this autumn, although the new UK Prime Minister's policy response is likely to be to suppress gas prices, albeit at enormous fiscal cost, which would dampen down the inflation figures.

Understandably, central banks are coming in for a lot of criticism in the light of their poor forecasting records. Politicians are always looking for scapegoats but, here, they do have a case for criticising central banks' erroneous economic forecasts or, at least, for querying how they got their forecasts so wrong. For instance, in Australia, the government has instigated a review of the Reserve Bank of Australia, which was criticised for delaying interest rate rises in the face of rising inflation. The Governor of the RBA had previously described its forecasting as "embarrassing". Quite why a number of central banks got their forecasts so wrong is difficult to know. They are supposed to be independent but their monetary policy was certainly helpful to governments which were having to borrow huge sums of money to provide fiscal support to their economies. Cynics might suggest that they were too close to their governments, or it could be central bank "groupthink" but, whatever the reason, the delay in raising interest rates has almost certainly been some part of the reason why inflation is so high, although not as large a part as the economic fallout from the Russian invasion of Ukraine.

Whatever the reason, central banks now find themselves in a position they would rather not be in. Because inflation has got out of control, they are having to raise interest rates more steeply and more frequently than they probably would have had to do if they had started on their tightening policy earlier. At a time when real incomes are being depressed by the high rate of inflation, the tightening of monetary policy through sharper than normal interest rate increases and the reversal of QE through QT (quantitative tightening) will heighten the chances of a recession as central banks accord a higher priority to getting inflation under control. In normal circumstances, they would want to calibrate their interest rate rises to the position where they arrive at a neutral interest rate level where their monetary policies are neither expansionary or contractionary. Instead, they will most likely raise interest rates to a level which risks causing a recession simply because out of control inflation is considered a greater danger to their respective economies.

However, central banks' problems with inflation are exacerbated by the nature of it. If inflation was being driven by excess demand, then interest rate increases could be expected to dampen demand pressures and, through that effect, reduce inflation towards target levels. However, the drivers of inflation now are clearly cost push, namely energy and food where demand is much less price elastic and where energy supplies to Europe are partly at the whim of Russia. Increased wages may also come into the equation. Although dependence on Russian energy supplies is trying to be reduced, this takes time and there is no way round what could be a very difficult winter in Europe. The level of interest rates is likely to have only the smallest of effects when there is cost push inflation. The agricultural market has been thrown into disarray by the Russian invasion of Ukraine, both big food producers. What this means is that monetary policy is going to have to be implemented much more harshly than central banks would normally wish to do faced with the possibility of a recession.

At the moment, economic forecasts often still point to economic growth next year, but the immediate outlook, particularly in respect of energy, is so uncertain that forecasts have to be made with a good deal of trepidation. To give a feeling of what the experts are expecting, the IMF's forecast for economic growth in 2023 is 2.9%. Within that, its forecast for advanced economies is 1.4% growth and for Emerging Markets and Developing Economies 3.9%. All of the major developed economies are forecast to grow within the range of 0.5% (the UK) and 2.0% (Spain). US growth is put at 1.0%. Growth in China is estimated at 4.6% and for India at 6.1%. These forecasts were made in July and, although it is only a short time since then, one sees the news becoming worse, so one might reasonably expect downgrades on these forecasts.

What all this amounts to is that the chances of "stagflation" must be considered high. We already have inflation which is high and we may already have economic stagnation with little or no growth. This is an economic state which economists dread. If inflation were at much lower levels, then lowering interest rates again might give an economic lift but, with inflation at current levels, 8.5% in the USA, 10.1% in the UK and 8.9% in the eurozone, that is out of the question.

Against such a difficult background, are there any particularly dangerous fault lines? It seems to be a British trait to assume that things in the UK must be worse than elsewhere, but in other major countries there are major issues which have the potential to be worse than in the UK, even with its very significant problems, and no more so than in Europe which is at the centre of the energy crisis. Germany, for so long the economic powerhouse, is suffering, by its standards, very high inflation at 7.5%. Its energy dependence on Russia and the elimination of gas supplies from there could well put the country into severe recession next year, with all the negative knock on effects which this has. Italy, also significantly dependent on Russian energy, is now facing problematic elections after Mario Draghi, the well regarded Prime Minister, lost support in Parliament and resigned. Italy, the third largest member of the eurozone, has a huge debt burden at around 150% of GDP and this creates a vulnerability for the whole of the eurozone because of the potential effect on monetary union. As such, the rise in interest rates will be unwelcome news for the Italian finance industry. Like most other countries, the budget is in significant deficit, with the Economist Intelligence Unit, for example, forecasting a deficit of over 6% of GDP this year. Like the rest of the eurozone and elsewhere, bond yields were suppressed by central banks' QE, which indirectly helped to finance eurozone members' budget deficits. Now the European Central Bank has ended its QE, although continuing to reinvest principal proceeds, and it is starting on its programme of interest rate rises, with the first rise of 0.5% already having occurred. Without QE, some eurozone members would have been in serious financial trouble and now does not seem the best time to withdraw support, but, of course, the inflation outlook demands action. However, the eurozone government bond market is looking very strained and one measure is the widening divergence in, say, ten year government bond yields between Germany, the eurozone's best credit, and Italy, one of the weaker ones. At the time of writing, the gap between the two countries' yields is over 2.3 percentage points. This is more evidence of the absence of convergence within the eurozone. When the ECB was buying government bonds in the secondary market, investors could feel more sanguine about the creditworthiness of the issuers because there was regular support from the ECB. Now that has gone, one would expect investors to make more hard headed judgements. That the ECB clearly realises this is shown by its plan to introduce the Transmission Protection Instrument (TPI) which, it says, is to ensure the effective transmission of monetary policy within the euro area. Whilst QE was aimed at helping to suppress absolute levels of interest rates, the TPI is aimed at suppressing relative interest rate levels, say, between Germany and Italy, as one example. This is surely dangerous territory. The ECB would be making decisions on what were appropriate relative interest rates and step in to support the relevant countries' bonds in the market if the spreads were under pressure. The purchase would be subject to the relevant country having met certain criteria, but it begs the question of what business does a central bank have in deciding what the market should decide, i.e. relative yields, and, if the yield spread becomes alarmingly wide, is the ECB going to say that the country has not met its criteria and fail to support its bonds in the market and, therefore, set off a crisis which could doom the euro, a currency which is not based on optimal currency area considerations? Eligibility for purchases will be based on what the ECB called a "cumulative list of criteria". These include compliance with EU fiscal rules, the absence of severe macroeconomic imbalances, fiscal sustainability as judged by bodies including the European Commission, the European Stability Mechanism and the International Monetary Fund, and social and sustainable macroeconomic policies complying with European Commission recommendations. On paper, these are significant hurdles for a eurozone member to meet if its bond market is to be supported by the TPI, but the proof of the pudding will be in the eating. If, for example, the Italian government bond yield spread against the German Bund continues to widen, thus adversely affecting the transmission of monetary policy as the ECB would wish, would the ECB dare not to support the Italian bond market? The Italian government bond market is so large and Italy, as its third largest member, so important to the euro project, that failure to support the Italian bond market would cause a serious and perhaps existential threat to the euro. With elections coming up shortly in Italy, investors will be watching this market nervously. One should not underestimate the determination of those associated with the euro to ensure that the project survives and therefore if the spread between Italian government bonds (but it could be those of other eurozone members) and German Bunds widens to dangerous levels, we would expect the apparently strict criteria to be interpreted flexibly.

The incidence of high inflation is obviously due most recently to the supply disruptions and shortages caused by the Russian invasion of Ukraine and, prior to that, as discussed, the failure of central banks to act earlier in the face of rising inflation last year, but there are forces at work which suggest central banks may have difficulty getting monetary policy to bring down inflation to 2%, a previously broadly accepted target. The effects on supply chains of the Covid-19 pandemic and now the Russian invasion of Ukraine as well as rising China/Taiwan tensions, are likely to be felt for some time, if not permanently. In an ideal world, where trade flows freely and is frictionless, manufacturing companies, for example, will source components and other necessary imports from where they can be obtained most cheaply, subject to quality, and also on a "just in time" basis where imported and domestic components arrive just before they are required, thus obviating the need for large stocks and money tied up in working capital. That would have been the ideal position and many businesses worked on that basis, even if not quite in the optimal way which the theory would suggest. However, the enormous supply disruptions and costs caused, firstly, by the pandemic, and now by the war in Ukraine, will continue to force businesses to review their supply chains. Security of supply will rise up the list of priorities, whilst price is likely to be less of a consideration. Therefore, quite a substantial amount of "reshoring" is likely. So, in the trade off between supply security and price, the former will be a more important consideration, but with the effect of charging more for the final output from the business. A similar effect is likely to play out as a result of the tensions between China and Taiwan. Given China's commitment to taking back Taiwan at some stage and by force if necessary, international businesses sourcing components from China or Taiwan will be considering how to mitigate potential risks from a conflict and sanctions which may be imposed on China. Of course, obviously the hope is that this event will never occur, but the Russian invasion of Ukraine, which was an unprecedented event for many people and perhaps not on companies' risk scenarios, has concentrated attention. Both countries are important sources of components for a wide range of manufacturing industries, particularly semiconductors from Taiwan. Again, actions taken to mitigate this potential threat will most likely lead to higher price levels. At the beginning of this review, we mentioned perhaps the one bright spot in the economic situation, namely low unemployment levels in many countries and staff shortages arising, in part, from the "Great Resignation" which is driving up pay levels in a number of industries, hospitality and retail being good examples. If this situation is going to continue, then the cost push effects on inflation will continue. In response, businesses will look to automate as many of their activities as possible to contain costs, or perhaps those who retired early in the pandemic and now face rising inflation, at levels which they had not anticipated, decide to return to the labour force.

One of the most important variables in the inflation discussion, and the main cause of the present rocketing inflation levels, is obviously the price of energy. Diversifying sources of supply to reduce dependence on Russia takes time and the cost for many countries, Germany comes to mind here, will be severe, not only in price terms, but reduced output, as supplies to industry are rationed. It is difficult to take a view on this as geopolitical events are moving so quickly but, whilst the year on year effect of earlier price increases may eventually bring down the inflation rate, it will be to a higher price level than previously. Meanwhile the rate of increase of prices may worsen in the short term with some scary forecasts for the UK, for example, as mentioned earlier.

One does not envy anyone in government in the free world at the moment, so severe are the problems that ministers face. The USA is probably in the least bad situation. Its energy security is relatively robust, although, like almost everywhere else, inflation is a problem. It is facing the most aggressive monetary policy tightening both in terms of interest rate increases and quantitative tightening (QT), but has a better chance of avoiding recession than most. Its relatively good energy situation and the aggressive monetary policy being followed almost certainly accounts for the strength of the US dollar against other currencies. In the developed world, the UK and Continental Europe face the greatest problems. In the UK, inflation is likely to rise well into double figures as a result of further sharp increases in the price of energy subject to action by the new UK Prime Minister and her cabinet which may suppress the inflation figures, albeit at the expense of significant fiscal loosening. With around a quarter of the stock of UK government bonds being index linked, the costs in terms of interest payments and future principal redemption payments will be enormous. There will be a huge challenge facing the new UK Prime Minister. The problems facing the eurozone and Continental Europe generally are equally daunting and, perhaps, even worse. For countries like Germany, its energy policy is having to be rewritten, at least in the short term, since its overdependence on Russian gas has come back to haunt it. The challenge to monetary union is enormous. As we have often written, the eurozone is not an optimal area and the challenges we have described above to Italy, for example, especially with an election coming up, are huge. It is likely that the TPI will have to be implemented, whatever the criteria used, since it is too important an economy for the eurozone not to support. The pound and euro have both been weak currencies, not surprising in view of their particular problems.

Japan, too, is having to have a big rethink. Whilst its inflation rate is low, currently 2.3% year on year, its energy position is weak as it has no indigenous sources of supply so is dependent on other countries. It is having to go back to nuclear power again after abandoning most of its nuclear power stations in the aftermath of the Fukushima disaster in 2011, following a very severe earthquake. It is also having to rethink its defence policy in the light of rising tensions with China.

China has its own set of problems. Monetary policy is an outlier in that the central bank is the only one loosening monetary policy in the face of a severe economic slowdown exacerbated by its Covid-19 policy, which aims to eliminate the disease from China, and is executing this policy by closing down whole swathes of the economy in areas where Covid-19 is detected with consequential adverse effects on economic activity. Besides bringing the economy to a standstill, as it did in the second quarter, its importance as a supplier of goods and components to the rest of the world has meant manufacturing problems elsewhere. Independently of its self inflicted economic damage caused by the lockdowns, foreign investors have been spooked by regulatory actions and some anti business measures, which have hit some companies badly. The serious state of the real estate market has led to associated problems for the banks. Concern over China's immediate threats to Taiwan also remain a consideration for foreign investors. China, therefore, has a different set of problems to those of most western economies.

For developing markets generally, the present situation represents a perfect storm. A combination of rising inflation due to energy and food price increases and serious sovereign debt problems are causing acute problems for many countries, particularly in Africa. In Asia, there has already been a default by Sri Lanka. Furthermore, because a lot of developing countries' debt is US dollar denominated, the servicing and repayment of the debt is becoming problematical, so more defaults are likely.

So what does all this mean for investment policy if the immediate outlook is as bad as painted? The first obvious point to make is that one has to hold an asset of some sort and the second less obvious one is that the gloomy background does not necessarily read across to all asset classes. We think that the most sensible way to approach the issue is to decide which assets are clearly unattractive and the fixed interest markets fits this category. Although yields have risen significantly from their low point and negative yields such as were seen in the German and Swiss government bond markets have disappeared, measured against current and foreseeable inflation they look to us still to be significantly overvalued. With central banks moving more quickly and more decisively to tighten monetary policy and large budget deficits still being run, the supply of fixed interest securities will increase and act to raise bond yields further. The significant negative real yields being seen on bonds still leaves plenty of price risk. We would not normally invest in gold but it is worth mentioning here as one of its historic attributes has been a store of value in troubled times. Times are certainly troubled at the moment but gold has not reacted as might have been expected in the past and, with interest rates set to rise, possibly quite sharply, it appears unlikely to fulfil its historic role in troubled times. We mention cryptocurrencies only to dismiss them. They were a function partly of cheap money which encouraged speculative frenzies and it is astounding how many people have been sucked into them. As regulators have said, these could go to nothing and it remains a real puzzle as to why the market became so big. Some investors have taken painful losses and it is difficult to imagine that we would ever invest in this area. Cash as an asset class, as opposed to being held for short term requirements or an opportunistic investment in weak markets against the background of a more or less fully invested position, may be less unattractive than bonds in the short term. This is because, with current inflation trends, it will be losing money in real terms, but the nominal amount will be unchanged, whereas, in the fixed interest market, bond prices are likely to fall, adding a second unattractive feature. This would only be an attractive asset class for an extremely risk averse investor. This leaves equities. In normal circumstances, with inflation very high, interest rates would be much higher than they are at present, probably in line with inflation or higher to give a positive real interest rate. In those particular circumstances cash would have been a good alternative in advance of an opportunity, hopefully, to buy into equity markets lower down. Now that alternative looks unattractive. The environment is very tough for many companies facing sharply rising costs, but some companies are able to pass these on and, for the moment, profits are holding up and many companies are raising their dividends. Property, in principle, has a widespread appeal as an asset class, but individual properties have a concentration risk and as an investment have become a political target, either through reduced taxation reliefs, additional stamp duty and, now, in Scotland a rent freeze, which is highly damaging to the potential supply of properties and reduces its attraction. As part of an equity portfolio, it is possible to diversify the risk and choose favoured real estate sectors which might be office, retail, residential or industrial. We would include these in our equity portfolios if considered attractive. Given that the trend is for equities to rise over time and the paucity of alternative options and given that one has to invest somewhere, we continue to believe that equities are the best asset class in which to be invested. Geographical diversification remains of paramount importance and, as we say in our review, the USA faces fewer economic problems than elsewhere and this remains our main focus of investment. Whilst we do not invest for currency reasons, the strength of the US dollar has provided some support for sterling based investors. With the geopolitical and economic news so grim, there are bound to be weak periods in the equity markets and negative quarters, but this should not distract an investor for the longer term attractions of equities. Geographical diversification and high quality investments should be the basis of a portfolio.